

REPORT OF THE AUDITOR-GENERAL TO EASTERN CAPE PROVINCIAL LEGISLATURE AND COUNCIL ON MAKANA LOCAL MUNICIPALITY

Introduction

1. I was engaged to audit the financial statements of the Makana Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the separate financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these separate financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on the separate financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matter described in the basis for disclaimer of opinion paragraph, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

4. I was unable to obtain sufficient appropriate audit evidence regarding the financial statements as a whole, as the financial statements were presented for auditing purposes without accurate and complete underlying accounting records. I was unable to audit the financial statements by alternative means. Consequently, I was unable to determine whether any adjustments relating to the financial statements as a whole were necessary.

Disclaimer of opinion

5. Because of the significance of the matter described in the basis for disclaimer of opinion paragraph, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

6. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Material losses/impairments

7. As disclosed in note 33 to the financial statements, material losses to the amount of R22,5 million (2013: R23,5 million) were incurred as a result of a write-off of irrecoverable trade debtors.

8. As disclosed in note 52 to the financial statements, the municipality incurred material losses relating to electricity of R40,4 million (2013: R67,8 million) due to the poor management of electricity connections and illegal electricity connections.
9. As disclosed in note 52 to the financial statements, the municipality incurred material losses relating to water of R31 922 (2013: R1,3 million) due to deteriorating water infrastructure, faulty meters and illegal water connections.

Restatement of corresponding figures

10. As disclosed in note 51 to the financial statements for the year ended 30 June 2014, the municipality restated corresponding figures for 30 June 2013.

Significant uncertainties

11. With reference to note 49 to the financial statements, the municipality was the defendant in a number of lawsuits estimated at R60,1 million (2013: R6 million). The outcome of these lawsuits cannot be determined at present as litigation is still in progress.

Irregular expenditure

12. As disclosed in note 46 to the financial statements, the municipality incurred irregular expenditure amounting to R37,3 million during the year ended 30 June 2014. This was as a result of non-compliance with procurement requirements.

Fruitless and wasteful expenditure

13. As disclosed in note 45 to the financial statements, the municipality incurred fruitless and wasteful expenditure amounting to R888 984 during the year ended 30 June 2014. This was as a result of the payment made to a service provider for goods and services not received.

Additional matters

14. I draw attention to the matters below.

Unaudited supplementary schedules

15. The supplementary information as set out on pages 76 to 91 does not form part of the financial statements. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

Unaudited disclosure notes

16. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Withdrawal from the audit engagement

17. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislative requirement to perform the audit of the municipality, I would have withdrawn from the engagement in terms of International Standards on Auditing.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

18. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected programmes presented in the annual performance report, compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

19. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected programmes presented in the annual performance report of the municipality for the year ended 30 June 2014:

- Programme 1: Technical and infrastructure on pages xxx to xxx
- Programme 4: Budget and treasury on pages xxx to xxx

20. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

21. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned programmes. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for managing programme performance information (FMPPPI).

22. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

23. The material findings in respect of the selected programmes are as follows:

Programme 1: Technical and infrastructure

Usefulness of reported performance information

Measurability

Performance indicators not well defined

24. The FMPPPI requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. Thirty two percent (32%) of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow data to be collected consistently. This was due to a lack of proper systems and processes around performance management within the entity.

Reliability of reported performance information

25. The FMPPPI requires the municipality to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. The reported performance information was not accurate when compared to the source information or evidence provided. This was due to a lack of standard operating procedures for the accurate recording of actual achievements.

Programme 4: Budget and treasury

Reliability of reported performance information

26. The FMPPi requires the municipality to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. The reported performance information was not accurate when compared to the source information or evidence provided. This was due to a lack of standard operating procedures for the accurate recording of actual achievements.

Additional matter

27. I draw attention to the following matter:

Achievement of planned targets

28. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected programmes reported in paragraphs 24 to 26 of this report.

Compliance with legislation

29. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

30. The performance management system and related controls were inadequate as they did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement; and how they were conducted, organised and managed, including determining the roles of the different role players, as required by section 38 of the Municipal Systems Act, 2000 (Act No. 2 of 2000)(MSA) and regulation 7 of the Municipal planning and performance management regulations.

31. Measurable performance targets for the financial year regarding each of the development priorities or objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and regulation 12(1) and 12(2)(e) of the Municipal planning and performance management regulations.

32. The annual performance report for the year under review did not include appropriate measures taken to improve performance, as required by section 46(1)(c) of the MSA.

33. Sufficient appropriate evidence could not be obtained that the annual performance agreements for the municipal manager and all senior managers were linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan, as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.

Budgets

34. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Financial statements, performance and annual reports

35. The financial statements submitted for auditing were not prepared, in all material respects, in accordance with the requirements of section 122 of the MFMA.
36. The 2012-13 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.

Audit committees

37. The audit committee did not advise the council on the performance management and performance evaluation, as required by section 166(2)(a) of the MFMA.
38. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
39. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by regulation 14(4)(a)(ii) of the Municipal planning and performance management regulations.
40. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by regulation 14(4)(a)(i) of the Municipal planning and performance management regulations.
41. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by regulation 14(4)(a)(iii) of the Municipal planning and performance management regulations.
42. The audit committee was not constituted, in the manner required by section 166(4)(a) of the MFMA, as it did not consist of at least three persons with appropriate experience .
43. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

Internal audit unit

44. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

Procurement and contract management

45. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, as required by supply chain management (SCM) regulation 17(a) and (c).
46. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded only to bidders who submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
47. Contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act No.5 of 2000.

48. Contracts were awarded to bidders based on preference points that were not calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act No. 5 of 2000 and Preference Policy Regulations of 2011.
49. Awards were made to providers who were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards had been identified in the previous year and no effective steps were taken to prevent the abuse of the SCM process, in accordance with SCM regulation 38(1).
50. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were only awarded to providers whose tax matters have been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
51. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board (CIDB), as required by section 18(1) of the CIDB Act No. 38 of 2000 (as amended) and CIDB regulations 17 and 25(7A) of 2004 (as amended).

Human resource management and compensation

52. An acting chief financial officer was appointed for a period of more than three months without the approval by the member of the executive council for local government, in contravention of section 54A(2A) of the MSA.
53. The competencies of financial and SCM officials were not assessed in a timely manner in order to identify and address gaps in competency levels, as required by regulation 13 of the Municipal regulations on minimum competency levels.
54. Sufficient appropriate audit evidence could not be obtained to confirm that the annual report of the municipality reflected information on compliance with prescribed minimum competencies, as required by regulation 14(2)(b) of the Regulations on minimum competency levels.
55. The head of the SCM unit was appointed without having met the prescribed minimum competency levels, as required by section 54A(2) of the MSA.
56. An approved staff establishment was not in place, as required by section 66(1)(a) of the MSA.
57. The head of the SCM unit, finance officials and senior manager for technical service did not have the higher education qualification, as required by section 119 of the MFMA and regulations 8, 9, 10 and 11 of the Municipal regulations on minimum competency levels.
58. Sufficient appropriate audit evidence could not be obtained to confirm that senior managers, finance officials and SCM manager met any of the prescribed competency areas, as required by regulations 6, 7, 8 and 9 of the Municipal regulations on minimum competency levels.
59. The municipal manager and senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) MSA.

Expenditure management

60. Money owed by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
61. Payments were made from the bank account without the approval of the accounting officer or a properly authorised official, as required by section 11(1) of the MFMA.
62. Reasonable steps were not taken to prevent unauthorised expenditure, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants received

63. The municipal infrastructure grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 16(1) of DoRA.
64. The municipality did not evaluate its performance in respect of programmes or functions funded by the municipal infrastructure grant allocation, as required by section 12(5) of DoRA.
65. The municipality did not evaluate its performance in respect of programmes or functions funded by the municipal systems improvement grant allocation, as required by section 12(5) of DoRA.
66. The municipality did not evaluate its performance in respect of programmes or functions funded by the local government financial management grant allocation, as required by section 12(5) of DoRA.

Revenue management

67. An adequate management, accounting and information system which accounts for revenue, debtors and receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.
68. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Asset and liability management

69. An adequate management, accounting and information system which accounts for assets and liabilities was not in place, as required by section 63(2)(a) of the MFMA.
70. An effective system of internal control for assets and liabilities was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

71. Unauthorised, irregular as well as fruitless and wasteful expenditure was not always recovered from the liable person, as required by section 32(2) of the MFMA.
72. Sufficient appropriate evidence could not be obtained to confirm that cases of financial misconduct, which constitute a crime committed by senior managers and other employees, were always reported to the South African Police Service, as required by section 62(1)(e) of the MFMA.

Internal control

73. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and compliance with legislation included in this report.

Leadership

74. Top key management positions (i.e. the Chief financial officer and Municipal manager positions) were vacant for more than half of the financial year. The continued absence of permanent officials in these key leadership positions to guide the municipal administration compromised the effectiveness of the control environment and undermined accountability.

75. During the financial year, the municipal manager was dismissed due to matters relating to alleged fraud. The vacancies in top key management positions contributed to the administrative instability within the municipality to the extent that the municipality had to be placed under administration by the department of co-operative governance and traditional affairs subsequent to the year-end. This instability during the year affected the operations of the municipality and undermined accountability.

76. The leadership did not implement effective human resource management to ensure that adequately and sufficiently skilled resources were in place (especially the finance department) and that performance is monitored and where necessary consequence management is applied. The inability to address and prioritise this critical area has a direct bearing on the number of compliance findings reported and the poor status of recordkeeping leading to the disclaimer of opinion.

77. The leadership did not institute all the disciplines necessary to enable effective oversight that promotes efficiency and effectiveness in financial management, service delivery reporting and compliance with laws and regulations, thus not setting the correct tone for the credibility of all reports generated by the municipality.

Financial and performance management

78. The municipality did not have a proper record management system in place to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting. This resulted in the amounts disclosed in the financial statements not being supported by the required information and listings which reconciles with the relevant accounting records and source documentation.

79. The implementation of controls over daily and monthly processing and key reconciliations of transactions was not performed consistently throughout the year and was therefore not effective to ensure positive cash flow management by means of collecting amounts due from consumers without delay and subsequently settling of accounts due to suppliers within a reasonable time.

Governance

80. The internal audit unit was not effective in their review of internal controls and compliance with laws and regulations. This is largely as a result of the instability within the municipality and the lack of co-operation from management.

81. As a result of the impaired functioning of the internal audit function, the audit committee could not effectively evaluate and monitor responses to risks and provide effective oversight in respect of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

OTHER REPORTS

Investigations

82. There were a number of investigations conducted relating to allegations pertaining to the irregular appointment of consultants (technical services), irregular appointment of employees for the period between 1 April 2013 and 31 December 2013, irregular donation expenditure, irregular payments of legal fees and the lost personnel file of the previous municipal manager. All these investigations were performed by an independent consulting firm. The report on the findings of these investigations was still in draft at the time of issuing this report.

Auditor-General

East London

28 November 2014



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